Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1996

TIMOTHY J. ANDERSON, NEIL SINGER and ARTHUR SINGER, On Behalf of Themselves and All Others Similarly Situated,

Petitioners,

vs.

GARY W. CLOW, DOUGLAS L. WHITING, ROBERT W. JOHNSON, ARTHUR J. COLLMEYER, JOHN R. WITZIL, STAC ELECTRONICS, INC., ALEX. BROWN & SONS, INC. and MONTGOMERY SECURITIES,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

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I. INTRODUCTION

None of Respondents' reasons for denying the Petition for Certiorari withstands scrutiny.

Respondents say that the law applied by the Ninth Circuit in this case has been superseded by the Private Securities Exchange Act of 1995 ("PSLRA"). This is not true. Respondents contend that the PSLRA "heightened the requirements for pleading *scienter*, provided safe harbors for certain forward-looking statements, and made explicit the particularity requirements for securities fraud claims." Stac Opp. at 11. But *scienter* is not relevant to the Securities Act §11 claims at issue in this case, *see Herman & MacLean v. Huddleston*, 459 U.S. 375, 381-82 (1983), and the PSLRA's particularity requirements for securities-fraud claims apply, by their terms, only to fraud-based Securities Exchange Act claims, not to Securities Act claims. *See* 15 U.S.C. §78u-4(b). Respondents *concede* that the PSLRA's safe harbor for forward-looking statements does not supersede the conflicting bespeaks-caution case law. *See* Stac Opp. at 18. Thus, the PSLRA does not supersede *any* issue raised by the Petition for Certiorari.

Respondents nonetheless contend that the proper pleading burdens for §11 claims are immaterial, because the Ninth Circuit dismissed plaintiffs' claims under the bespeaks-caution doctrine. But a court should have no occasion to apply bespeaks-caution analysis unless Rule 9(b) requires falsity to be pleaded with particularity in a

§11 complaint. In addition, the Ninth Circuit's bespeaks-caution holding itself warrants review – and reversal.

Respondents say the petition identifies no conflict of consequence, but subjecting §11 claimants to heightened pleading standards conflicts with this Court's holdings that §11 claimants cannot be required to plead or prove fraud, *Huddleston*, 459 U.S. at 381-83, and that nonfraud claims cannot be subjected to heightened pleading requirements. *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 167-68 (1993). The notion that Rule 9(b) protects defendants who violate §11 *with intent to defraud*, because plaintiffs' claims then "sound in fraud," is ludicrous. Section 11 places the burden of pleading and proving good faith and due diligence on defendants, not plaintiffs. 15 U.S.C. §77k(b)(3); *Huddleston*, 459 U.S. at 382.

Finally, Respondents cannot paper over the conflicts among the circuits' bespeaks-caution precedents.

The questions presented are very important – going to the heart of what must be pleaded to state Securities Act claims. Decisional law in the lower courts is extensive and confused, the issues are not resolved by the PSLRA, and the time is ripe for this Court to resolve the conflicts in that law.

II. ARGUMENT

A. The Private Securities Litigation Reform Act Of 1995 Neither Supersedes Nor Eliminates Conflicts In Existing Law On The Questions Presented

The PSLRA does nothing to "supersede" the issues presented by the Petition for Certiorari. If anything, enactment of the PSLRA heightens the importance of the questions presented.

The PSLRA's codification of particularized-pleading requirements for fraud-based Exchange Act claims does not affect the principle that particularized pleading cannot be required for strict-liability Securities Act claims. While the PSLRA requires particularized pleading of *fraud* claims *under the Exchange Act*, 15 U.S.C. §78u-4(b), it says nothing about particularity for pleading strict-liability *Securities Act* claims. *Compare* 15 U.S.C. §77z-1(b) *with* 15 U.S.C. §78u-4(b).

The PSLRA's "safe harbor" for forward-looking statements, 15 U.S.C. §78u-5(c), neither applies to a prospectus for an initial public offering, 15 U.S.C. §78u-5(b)(2)(D), nor supersedes existing bespeaks-caution case law – as Respondents themselves admit. *See* Stac Opp. at 18. Congress "[did] not intend for the safe harbor provisions to replace the judicial 'bespeaks caution' doctrine or to foreclose further development of that doctrine by the courts." H.R. Conf. Rep. No. 104-369, 104th Cong., 1st Sess. at 46, *reprinted in* 1995 U.S.C.C.A.N. 730, 745. Stac concedes that given the PSLRA's recent "Congressional endorsement of the doctrine, there can be no question but that the doctrine should continue to apply to securities fraud claims."

Stac Opp. at 18. This disposes of any contention that the PSLRA somehow "supersedes" conflicting bespeaks-caution precedents.

B. Pleading Standards For Section 11 Claims Warrant This Court's Review

Respondents try to trivialize the issue of what pleading standards should govern plaintiffs' §11 claims, arguing that appropriate pleading standards are immaterial because the Ninth Circuit found that any misstatements are not actionable under the bespeaks-caution doctrine. This makes no sense.

Under Ninth Circuit law, *Rule 9(b)* requires plaintiffs to plead evidentiary facts raising an inference of falsity.[1] Obviously, if Rule 9(b) does not apply plaintiffs are not required to demonstrate falsity in the complaint.[2] If falsity need not be shown in the complaint, however, a court has no occasion – or right – to make a bespeaks-caution inquiry in order to determine, at the pleading stage, whether or not defendants' statements were actionably misleading. Simply put, the Ninth Circuit could not properly rely on the bespeaks-caution doctrine to dismiss Petitioners' §11 claims at the pleading stage unless Rule 9(b) applied to them. Thus, its bespeaks-caution holding only magnifies the importance of determining whether

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[1] *See Warshaw v. Xoma Corp.*, 74 F.3d 955, 960 (9th Cir. 1996); *Fecht v. Price Co.*, 70 F.3d 1078, 1082 (9th Cir. 1995), *cert. denied*, ___ U.S. ___, 116 S. Ct. 1422 (1996); *In re Glenfed, Inc. Sec. Litig.*, 42 F.3d 1541, 1547-49 (9th Cir. 1994) (en banc).

[2] *See Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974); *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

Rule 9(b) fraud pleading standards apply to strict-liability §11 claims.

Brushing aside conflict among the district court decisions, Respondents say there is no inter-circuit conflict. Respondents thus ask this Court to ignore the conflict of the decision below (and other cases) with its own holdings that §11 claims *are not claims for fraud*, *Huddleston*, 459 U.S. at 381-82, and that heightened pleading requirements cannot be extended beyond the narrow scope of Rule 9(b)'s text – which allows courts to require particularity only in averments of fraud or mistake. *Leatherman*, 507 U.S. at 167-68.

Respondents also hope this Court will ignore the conceptual incoherence of decisions holding that although neither fraud nor negligence is an element under §11, plaintiffs nonetheless must plead one or the other with particularity.[3] This frustrates a legislative scheme that places *on defendants* the burden of pleading and proving that they acted in good faith and with due diligence – *as an affirmative defense*. *See* 15 U.S.C. §77k(b)(3); *Huddleston*, 459 U.S. at 382; Louis Loss & Joel Seligman, *Fundamentals of Securities Regulation* 1005-06 (3d ed. 1995). Plaintiffs cannot be required to plead on the subject of an affirmative defense. *Gomez v. Toledo*, 446 U.S. 635, 640 (1980).

According to Respondents, although §11 imposes strict liability for a misleading registration statement, they are entitled to avoid liability under Rule 9(b) in this

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[3] *See, e.g., Shapiro v. UJB Financial Corp.*, 964 F.2d 272, 287-88 (3d Cir. 1992) (applying Rule 9(b) because complaint lacked "allegations that defendants were negligent in violating, §§11 and 12"); *compare* 11a n.2; 41a n.3.

case if the facts alleged suggest that they acted with fraudulent intent – because any suggestion of scienter makes the claims "sound in fraud." This is wrong: "Even where a plaintiff's complaint improperly contains allegations that seek to avoid or defeat a potential affirmative defense, 'it is inappropriate for the court to shift the burden of proof on the anticipated defense to plaintiff as a "sanction" for failing to follow the burden of pleading structure established by Rule 8 or by adopting the fiction that plaintiff's anticipation of the issue evidences his intention to "assume" the burden of proving it.' "[4]

The notion that Rule 9(b) provides protection to defendants who violate §11 *with intent to defraud* because plaintiffs' claims then "sound in fraud," turns logic on its head and perverts the fundamental framework of the Securities Act. That act places the burden of pleading and proving good faith and due diligence on defendants, not plaintiffs. 15 U.S.C. §77k(b)(3). Congress believed that "[t]he provisions throwing upon the defendant in suits under sections 11 and 12 the burden of proof to exempt himself are indispensable to make the buyer's remedies under these sections practically effective," for "[e]very lawyer knows that with all the facts in the control of the defendant it is practically impossible for a buyer to prove a state of knowledge or a failure to exercise due care on the part of defendant." H.R. Rep. No. 85, 73d Cong., 1st Sess. at 9 (1933).

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[4] *Vance v. Terrazas*, 444 U.S. 252, 269 n.11 (1980) (quoting 5 Charles Alan Wright & Arthur R. Miller, *Federal Practice And Procedure* §1276, at 327 (1969); *see* 5A Charles Alan Wright & Arthur R. Miller, *Federal Practice And Procedure: Civil 2d* §1276, at 460-61 (2d ed. 1990).

The Ninth Circuit has reversed the statutory burdens of pleading and proof, by holding that plaintiffs in this case must plead *fraud* with particularity to proceed with their §11 claims, and the issue is ripe for this Court's review.

C. The Bespeaks-Caution Doctrine Is Ripe For This Court's Review

The time also is ripe for this Court to consider the so-called bespeaks-caution doctrine, which has been developed and applied by many lower federal courts to provide " 'a mechanism by which a court can rule as a matter of law that defendants' forward-looking representations contained enough cautionary language or risk disclosure to protect the defendant against claims of securities fraud.' " 19a-20a (quoting *Fecht v. Price Co.*, 70 F.3d 1078, 1081 (9th Cir. 1995), *cert. denied*, ___ U.S. ___, 116 S. Ct. 1422 (1996)).

Conflicts in the bespeaks-caution case law run deep. Confusion about the controlling law is evident even in Respondents' briefs – which blithely cite an overruled Sixth Circuit decision, *Sinay v. Lamson & Sessions Co.*, 948 F.2d 1037 (6th Cir. 1991), as an example of the many bespeaks-caution circuit court decisions that supposedly all apply "substantially the same rule." Alex. Brown Opp. at 20; *see* Stac Opp. at 17. In fact, the Sixth Circuit itself held in *Mayer v. Mylod*, 988 F.2d 635, 638-40 (6th Cir. 1993), that *Sinay* conflicts with this Court's holding in *Virginia Bankshares v. Sandberg*, 501 U.S. 1083, 1096-98 (1991), and that cautionary boilerplate is no automatic bar to liability under the federal securities laws.

Some courts, ignoring *Virginia Bankshares*, readily apply the bespeaks-caution doctrine at the pleading

stage, dismissing many claims as a matter of law. *See* Stac Opp. at 16. Others, like the Seventh Circuit, frown on its application at the pleading stage, *Roots Partnership v. Lands' End, Inc.*, 965 F.2d 1411, 1417 n.5 (7th Cir. 1992), and "have yet to encounter a case where the doctrine applied to negate the materiality of a misleading statement as a matter of law," at *any* stage of litigation. *United States v. Morris*, 80 F.3d 1151, 1167 (7th Cir.), *cert. denied*, ___ U.S. ___, 117 S. Ct. 181 (1996).

Disputes regarding the character and scope of the bespeaks-caution doctrine obviously involve more than "case-by-case" differences in application of settled law. Some decisions – including the one below – hold that disclaimers that there can be "no assurance" that representations will prove accurate eliminate liability as a matter of law.[5] Others hold that indistinguishable "no assurance" disclaimers cannot eliminate liability as a matter of law.[6] In many instances courts have held that warnings and disclosures far more extensive than those at issue in this case do not avoid liability as a matter of law.[7] The First Circuit has held that the doctrine does not apply

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[5] *E.g., Olkey v. Hyperion 1999 Term Trust*, 98 F.3d 2, 6-7 (2d Cir. 1996) (relying on "no assurance" disclaimer to dismiss complaint over Chief Judge Newman's dissent).

[6] *E.g., Morris*, 80 F.3d at 1166-68; *Harden v. Raffensperger Hughes & Co.*, 65 F.3d 1392, 1404-06 (7th Cir. 1995); *Rubinstein v. Collins*, 20 F.3d 160, 163-64, 166-68 (5th Cir. 1994).

[7] *See, e.g., In re Westinghouse Sec. Litig.*, 90 F.3d 696, 708-10 (3d Cir. 1996); *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1213-14 (1st Cir. 1996).

when plaintiffs contend historical financial results are misleading,[8] but the Ninth Circuit applied the doctrine to overstated historical financial results in this case.

To put it bluntly, this body of law is incoherent, and it is time for this Court to intervene and restore order.

III. CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be granted.

DATED: February 11, 1997

Respectfully submitted,

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[8] *Shaw*, 82 F.3d at 1213.